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December 10, 2004

Director, Tobacco Division
Farm Service Agency
United States Department of Agriculture
1400 Independence Avenue, S.W.
STOP 0514, Room 4080-S
Washington, D.C. 20250-0514

Re: Comments on Tobacco Buyout Assessments

Dear Director:

I am transmitting herewith an original and five copies of Comments of the Cigar Association of America, Inc. in response to the Department of Agriculture's Federal Register Notice of November 17, 2004, welcoming written comments on the tobacco buyout assessment provisions in Pub. L. No. 108-357, Title VI. It is clear to us that there are many defects in this legislation, some of a fundamental nature. To begin with, the inclusion of cigar manufacturers and importers is entirely unjustified for the reasons stated, although that is presumably something beyond the power of the Secretary of Agriculture to remedy. We do, however, believe the Secretary has sufficient authority - - and we urge the Secretary to exercise that authority - - to safeguard the confidentiality of a cigar manufacturer's or importer's traditional, proprietary business information from disclosure, directly or indirectly, to competitors or any other entity, private or public. Some of the provisions are simply unworkable, particularly the subsequent allocation provisions where the Secretary's authority to adopt a formula, other than the one prescribed by statute, is severely limited.

Nevertheless, we have tried to submit constructive remarks where the statutory provisions lend themselves to administrative interpretation and refinement. If we can be of further assistance to the Department of Agriculture and its constituent agencies, such as the Commodity Credit Corporation, please do not hesitate to contact me.

Sincerely

Norman Sharp

Norman F. Sharp
President

Enclosures

Before the Commodity Credit Corporation
U.S. Department of Agriculture

COMMENTS OF THE CIGAR ASSOCIATION OF AMERICA, INC. ON TOBACCO BUYOUT ASSESSMENTS

(December 10, 2004)

These comments are submitted pursuant to the November 17, 2004 Federal Register Notice (69 F.R. 67298) published by the Commodity Credit Corporation to solicit written comments regarding the implementation of the assessment provisions of the Fair and Equitable Tobacco Reform Act of 2004. The members of the Cigar Association account for over 96% of cigars manufactured, imported and sold in the United States.

A. In General

On October 22, 2004, the President signed Pub. L. No. 108-357 into law. Title VI thereof consists of the Fair and Equitable Tobacco Reform Act of 2004 ("FETRA") which provides for the buyout of current tobacco quota owners and growers. The buyout, administered by the Secretary of Agriculture, is to be funded by quarterly assessments of different classes of tobacco product manufacturers and importers over a 10-year period. The cost of the buyout is limited to $10.14 billion.

Payment liability for the assessments is allocated by class of tobacco product manufacturers and importers starting with the 2005 crop year. The initial allocation for the cigar class is fixed by section 625(c)(1) at 2.783%. At that rate, the burden on the cigar industry will be $282 million over the next 10 years. For subsequent fiscal years, the Secretary is authorized to adjust the initial allocation for each product class to reflect shifts in the share of the gross domestic volume for tobacco products represented by each class. The manufacturers and importers within each class are subject to quarterly assessments on a pro rata basis.

B. Erroneous Premise of Initial Allocation

It is our understanding that the theoretical justification for the tobacco buyout assessments is that the manufacturing beneficiaries of the Federal tobacco quota/price support program should bear the cost of retiring that program. As it relates to cigars, that rationale is invalid inasmuch as the usage of quota tobacco by members of the Cigar Association is virtually nil. This means that there is no rational basis to impose a substantial financial burden on a small class of businesses that received essentially no benefit from the tobacco quota/price support program. We recognize, of course, that the Secretary lacks authority to change the initial allocation among product classes, but it is important to point out that the assessment provisions the Secretary is called upon to implement, where cigars are concerned, are grossly inequitable and oppressive, and dubious as to their constitutionality.

To compound the injury, the initial allocation for cigars is based on invalid data. Specifically, the allocation was putatively based on cigar excise tax collections. However, the calculation erroneously assumed that all large cigars were taxable at the maximum rate of $48.75/1,000. In fact, a sizable number of cigars are sold at a price that yields a tax per 1,000 that is significantly lower. According to data from the IRS and TTB, the actual excise tax on cigars was 2.21% of the total excise tax on tobacco products, instead of the 2.783% figure for cigars in the initial allocation. That difference represents $58.1 million in additional assessments for the cigar class over the buyout period.

C. Subsequent Allocations

For subsequent years, the Secretary is required by section 625(c)(2) periodically to adjust the percentage for each class "to reflect changes in the share of gross domestic volume held by that class of tobacco product". As explained below, there is no way to determine changes in the share of gross domestic volume because there is no common base against which a shift can be measured among all the classes of tobacco products. Accordingly, the prescribed methodology for subsequent allocations is unworkable. This strongly suggests that, of necessity, the Secretary must continue to use the initial allocation prescribed in section 625(c)(1). As further discussed herein, there may be no other legitimate way to solve the problem administratively.[1]

The provision for subsequent allocations is unworkable because it is based on changes in the share of "gross domestic volume" held by that class of tobacco product, where gross domestic volume is defined in section 625(a)(2) as the volume of tobacco products "removed (as defined by section 5702 of the Internal Revenue Code of 1986)" and not otherwise exempt from taxation. In contrast, the initial allocations to each class of tobacco product under section 625(c)(1) are clearly not related to any measure of volume. We have been advised that the initial percentages are based on relative *federal excise tax burdens* among tobacco product categories (as confirmed in conversations with staff from the U.S. House Committee on Ways and Means and the U.S. House Committee on Agriculture) for fiscal year 2003.

Because the subsequent adjustments are based on changes in *gross domestic volume*, not changes in excise taxes paid, the Department of Agriculture is required to consider adjusting apples based on changes in oranges. Even worse, the volumes that must be considered are measured in different ways, with cigarettes and cigars being measured based on product *units* and the other categories being measured based on *pounds*. To continue the analogy, the Department is being asked to adjust apples based on changes in oranges, but some categories use the *number* of oranges and some categories use the *weight* of the oranges. So the Department will be unable even to compare oranges to oranges.

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[1] Immigration and Naturalization Service v. Chadha et al., 462 U.S. 919 (1983); ("[A]dministrative activity cannot reach beyond the limits of the **statute** that created it."). See also, Whitman v. American Trucking Associates, Inc., 531 U.S. 457 (2001).

Assuming, for purposes of discussion, that the Secretary has sufficient discretion to do so, there are two possible approaches that might be considered, other than maintaining the percentages prescribed for the initial allocation. The first involves creating two subcategories, reallocating the unit volume classes separately from the poundage volume classes for each subsequent year. The second involves adjusting the initial excise tax-based percentages each year based on the ratio of volume changes for each class of tobacco products. Both are examined below, including examples of their application. It can readily be seen that neither of these two approaches is satisfactory. Both bring highly skewed and inequitable results. We submit that, apart from the question of legal authority, both approaches should be rejected. Instead, the clearly preferable application of the subsequent allocations provision requires the Secretary to maintain the initial percentages in subsequent years as representing the clearest and, on balance, fairest way to implement the assessment provisions by class. In that connection, we note that section 625(c)(2) only requires the Secretary to make adjustments "periodically". That term is not defined by FETRA.

1. Annual adjustments based on subcategories.

Under this approach two subcategories would be created, reallocating the unit volume classes each year separate from the poundage unit classes. However, we believe dividing tobacco product classes into subcategories produces an unfair outcome. By way of example, the table below summarizes this approach. This option disregards the initial percentages for each class, making future adjustments based on volume within a subcategory. Cigarettes and cigars would be grouped together, since both are measured based on units. They would continue to pay a combined overall percentage of 99.114, based on the total of the initial percentages. However, that total percentage would be reallocated each year based on volume. Similarly, the other four categories would continue to pay a combined annual percentage of 0.887, based on the total of the initial percentages. As the table below shows, this approach would result in significant changes in the initial percentage allocated to each class.

ANNUAL ADJUSTMENTS BASED ON TWO SUBCATEGORIES
(Subcategory I = cigarettes and cigars; Subcategory II = snuff, RYO, chewing, pipe)

	Initial %	Base removables*	Year 2 hypothetical removables**	Sub-category %	New %
Cigarettes	96.331	399.768 billion	384.768 billion	97.962	97.094
Cigars	2.783	7.004 billion	8.004 billion	2.038	2.020
Snuff	0.539	73.662 mil. lbs.	71.662 mil. lbs.	53.466	0.474
RYO	0.171	12.607 mil. lbs.	12.607 mil. lbs.	9.406	0.083
Chewing	0.111	45.412 mil. lbs.	45.412 mil. lbs.	33.881	0.301
Pipe	0.066	4.853 mil. lbs.	4.353 mil. lbs.	3.248	0.029
TOTAL	100.001	n/a	n/a		100.001

2. Adjust initial percentages based on change in volume ratio.

Another approach is to adjust the initial excise tax-based percentages each year based on the ratio of volume changes for each class of tobacco products. The problem, however, is that some of the adjusted percentages will quickly grow far out of line with either their excise tax percentage (which is known) or their appropriate volume percentage (which requires certain assumptions to calculate). In addition, the percentages are unlikely to add up to 100% each time as different classes go up or down at different rates. The total volume change cannot be calculated fairly since some categories are based on units and others based on poundage.

The table below shows what new percentages would look like if the initial percentages were adjusted based strictly on the change in the volume ratio for each tobacco product class. For example, the hypothetical future numbers show a 4 percent drop in cigarette volumes, which would require that the initial percentage be multiplied by 0.96. This adjustment would produce a change in the overall percentage from 96.331 percent to 92.478 percent. Cigars, with a hypothetical 15.8 percent volume increase would see the tobacco buyout assessment percentage rise to 3.223 percent.

The problem with this approach is that the overall percentages are unlikely to balance at a total of 100 percent as different classes move up and down at different rates. Making a further adjustment to reach 100 percent, while mathematically possible, would be inconsistent with the language of FETRA, which limits the adjustments to those that "reflect changes in the share of gross domestic volume."

ANNUAL ADJUSTMENTS BASED ON STRAIGHT VOLUME RATIOS

	Initial %	Base removables*	Year 2 hypothetical removables**	Ratio	New %
Cigarettes	96.331	399.768 billion	384.768 billion	0.962	92.716
Cigars	2.783	7.004 billion	8.004 billion	1.143	3.180
Snuff	0.539	73.662 mil. lbs.	71.662 mil. lbs.	0.973	0.524
RYO	0.171	12.607 mil. lbs.	12.607 mil. lbs.	1.0	0.171
Chewing	0.111	45.412 mil. lbs.	45.412 mil. lbs.	1.0	0.111
Pipe	0.066	4.853 mil. lbs.	4.353 mil. lbs.	0.897	0.059
TOTAL	100.001	n/a	n/a		96.761

Notes for both charts:
* Base removables use 2003 calendar year data, as provided at http://www.ttb.gov/tobacco/stats/tobstats03/tob_dec03.pdf
** Year 2 hypothetical assumes cigarettes decline by 15 billion, cigars increase by 1 billion, snuff decreases by 2 million pounds, RYO and chewing remain unchanged, and pipe declines by 500,000 pounds. These figures represent a hypothetical mix that could potentially exist today, as category volumes routinely go up and down from year to year.

The two alternative approaches examined above are unworkable at best and certain to give rise to multiple challenges to assessments. **In our view, the best way to implement the subsequent allocations provision, in terms of law and equity, is for the Secretary to maintain in subsequent years the status quo established by the initial allocation percentages in section 625(c)(1).** We respectfully urge that the regulations reflect that interpretation.

D. Confidentiality

By the same token, section 625(d)(2) provides that the quarterly notice issued by the Secretary to manufacturers or importers will contain the market share of each competitor within the applicable class of tobacco product. There is no reason to believe that Congress intended the Secretary to compromise the confidentiality of production, sales, market share or other types of proprietary information that are kept close to the vest in the normal course of business. **Insofar as the U.S. cigar industry is concerned, individual company information should not be divulged to competitors or anyone else.** Accordingly, we urge that the regulation contain a provision requiring the consent of the particular manufacturer or importer in a class before divulging such proprietary information to other competitors in that class.

The implementing regulation should also contain a provision making it clear that individual copies of tax returns and other forms filed with another agency, and required to be supplied to the Secretary under section 625(h) of the Act, will not be disclosed to any other governmental agency (Federal, state or local) or private party under the Freedom of Information Act or otherwise. The reason is that Congress has recognized the sensitivity of such information and has prohibited the Alcohol and Tobacco Tax and Trade Bureau of the U.S. Treasury Department, for example, from disclosing any submitted return or return information with severe criminal penalties attached for any violation (26 U.S.C. 6103). There is no reason to believe that, when it passed Pub. L. 108-357, Congress intended to relax or minimize that safeguard. The policy imbedded in that statute should be followed by the Secretary of Agriculture, and clearly stated in the regulation.

It must be recognized that the strong protective policy reflected in 26 U.S.C. 6103 would be violated if the Secretary of Agriculture does not provide the equivalent safeguard for such excise tax return information. Otherwise, tobacco excise taxpayers would be treated differently than all other taxpayers in like circumstances, a result that would contravene the intent of Congress. In that context, it might be worthwhile to explore the possibility that this information might be obtained by the Secretary directly from TTB under an **interagency agreement** (which we believe is permissible under TTB's nondisclosure statute) on terms that would fulfill the protective purpose of that statute.

E. Administrative Challenges

A manufacturer or importer has the right under section 625(i) to contest the assessment if it notifies the Secretary of its intent to contest within 30 days after receiving the assessment notification. The Secretary is required to promulgate a regulation within 180 days of enactment establishing a procedure to facilitate such assessment challenges. The regulation must provide for the submission of "information" to the Secretary to demonstrate that the contested assessment is "incorrect". For purposes of precision, the regulation should define the terms "information" and "incorrect". Specifically, it should be made clear that "information" includes both points of fact and law and that "incorrect" encompasses determinations of fact and law. It is obvious that an assessment is "incorrect" if it is based on an erroneous application of the law or is not supported by the facts.

The term "amount" is also used, without definition, in several places in section 625(i). It is clear that the term is not a limitation on the dollar scope of a contested assessment. That is, a manufacturer or importer is entitled to contest the full amount of an assessment, in which case there would be no undisputed amount to pay the Secretary under section 625(i)(5).

F. Escrow Account

Under section 625(i)(5) manufacturers and importers may place into escrow any disputed assessment amount, if it is the subject of a good faith challenge, until a final determination of the claim is made. Presumably, such amounts would be paid into an interest-bearing escrow account. In that context, the regulation should specify that to the extent a manufacturer's or importer's claim is sustained, it is entitled to the interest generated in the escrow account.

G. Refund Procedure

The regulations promulgated by the Secretary should contain a refund procedure to cover those cases in which a basis to challenge the correctness of assessment does not occur until after the 30-day period between assessment notification and the intent-to-contest notification expires, such as a later court decision, having broad application, invalidating a certain category of assessment. The obligation of the Secretary to refund assessments in such situations and to provide an administrative procedure to effectuate that obligation is a necessary concomitant to the statutory command for the Secretary to assess "only the amount correctly determined" and "to ensure that each manufacturer and importer pays only its correct pro rata share".

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